

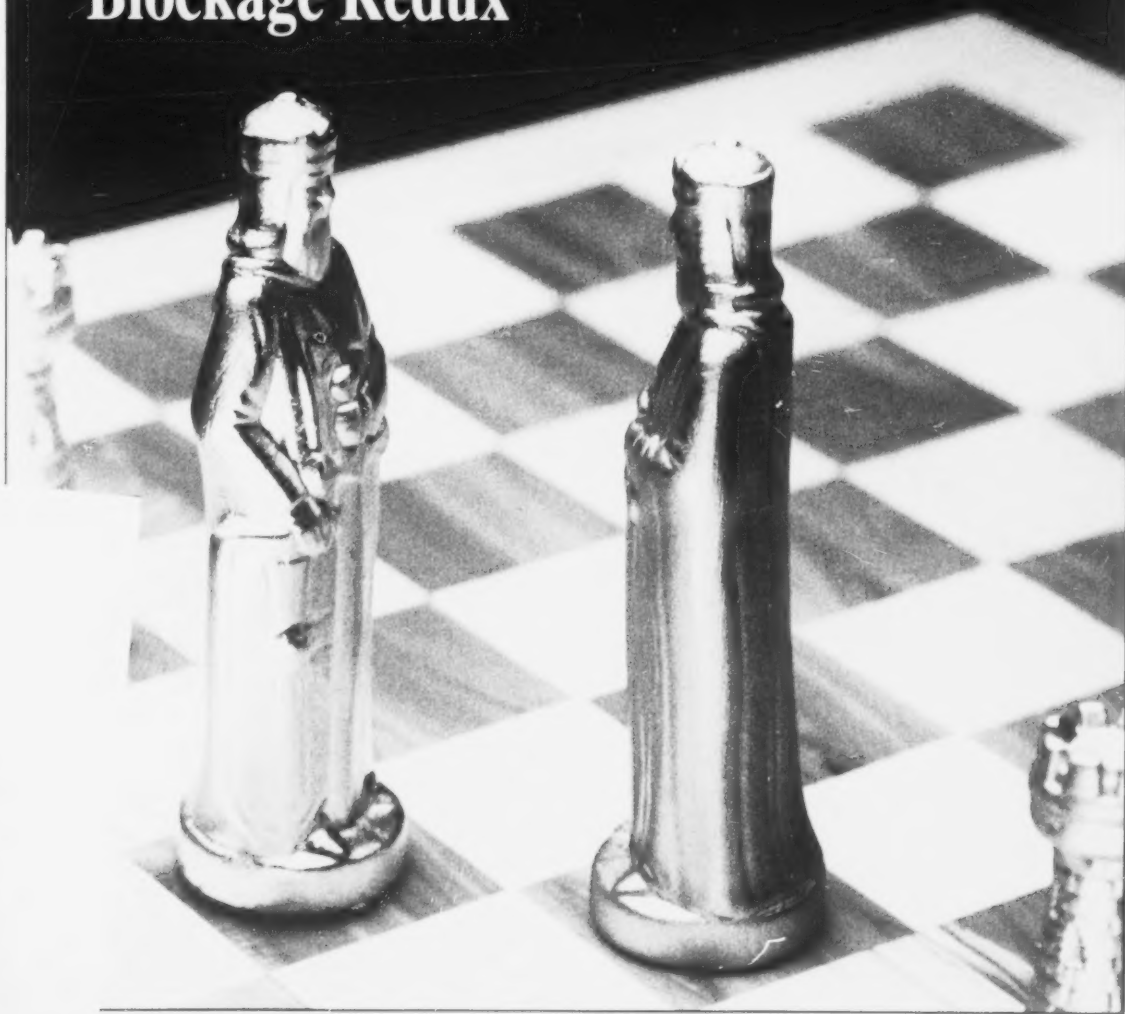
TRUSTS & ESTATES[®]

ESTATE PLANNING & ADMINISTRATION

A Publication of Communication Channels, Inc. FEBRUARY 1992

New Strategies In Estate Planning

A Valuation Problem- Blockage Redux



TRUSTS & ESTATES®

Volume 131, No. 2

Estate Planning and Administration since 1904

FEBRUARY 1992

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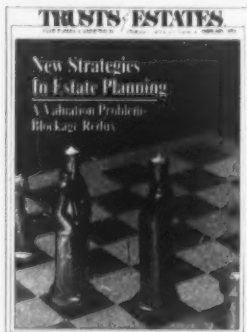
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Strategy is critical for creating a successful estate planning enterprise, particularly in today's constantly changing industry. Cover photo courtesy of Joseph Palmieri, Dover, NJ.



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Editor's Notes

Trying To Break Down The Barriers Of New Taxation

We ought to be used to it by now. As sure as there is a new year, there is sure to be a new tax bill in Congress. Actually, this year's version is a leftover from last year which has been flying in a holding pattern over the Capitol since mid-1991. The proposed changes which will eliminate some of the differences in the taxation of trusts and estates can be found in Sec. 441. However, since tax changes are political hot potatoes in this election year, it is very uncertain when the reforms will take place and what their final form will be. Nevertheless, you can be assured of two things. First, the new laws will be no less confusing and disconcerting than those of previous years and secondly, with the help of our editorial board and others, we will attempt to analyze and explain the new provisions as soon as possible.

In the meantime, there are some planning strategies and techniques of which all estate planners should be aware. This month we address

planning for the disappearing suspended passive activity losses of decedents and executors, post-mortem planning differences for trusts and estates and why the revocable trust is not a disadvantage, obtaining QTIP treatment for IRAs and qualified retirement plans while maximizing tax deferral, and valuation questions involving blockage.

Next month, we hope to present articles which will discuss generation skipping and reform proceedings, the beneficiaries' power to remove trustees, and some new charitable planning ideas.

The importance of continuing your education in the rapidly-changing estate planning environment cannot be understated. We would like to take this opportunity to thank all attendees of the Third Annual TRUSTS & ESTATES Conference on Estate Planning in San Francisco. We hope that the information you took away from the conference will serve you well all year and that we will see you again next year. □



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Charitable Giving

Charitable Trusts: The Magic Bullet

Fiduciary services and investment management services can live up to their profitability standards only if administrators do their homework

By **RUSS A. PRINCE**

Renaissance Applied Research
Carmel, IN

Providing financial services to the affluent is one of the most economically rewarding activities for a financial institution. For the most part, fiduciary services, as well as investment management services, are exceedingly profitable. At the same time, they are very low-risk endeavors.

These high returns for minimum risk have not gone unnoticed. A panoply of competitors are entering the field. For instance, aside from the plethora of banks, insurance companies and dedicated money managers, the mutual fund companies are now actively pursuing the wealthy investor.¹

Among those financial institutions with already well-established operations, there is considerable effort being undertaken to enhance their positions in the industry. Thus, not only are a great many new competitors entering the field, those competitors with a presence are taking extensive steps to magnify that presence.

Competition

While the profits are ever-present, the vast number of competitors make it more and more difficult for any in-

dividual financial institution to earn above-average returns. The problem is complicated by the fact that most competitors look to each other for strategies. This permits them all to make the same mistakes. What occurs is a process of management by default.² It is as if no one really wants to capitalize on the opportunities that exist in the industry.

Understanding The Psychology

Only by understanding the psychology of the well-to-do, as well as the manner in which structural dynamics affect their purchase decisions, will the financial institution be able to obtain above-average returns. Thus, market research is essential.

Market research has been able to delineate buying behavior patterns and related motivations of the affluent.³ Without question, such information is absolutely essential in order to achieve above-average returns. This information provides strategies and tactics which are absolutely crucial in order to effectively and efficiently market to the affluent.

Nevertheless, financial institutions are desperately seeking some magic bullet which will result in those

much craved above-average returns. To a great degree, it is wishful thinking. The desire of a financial institution is to be able to focus its energies in a manner which will enable it, as one senior manager of a universal private bank put it, "to get the most bang for the buck." Another said that he wanted the closest thing to a sure thing that existed in this industry.

Common sense says that if such a magic bullet existed among the voluminous number of competitors, someone would have found it. In fact, some have. However, all indications are that there are very few of them. Meanwhile, there is no reason for everyone not to profit also. In fact, it is quite possible for everyone to benefit.

After years of extensive research on the psychology of the affluent's purchasing of financial and related services, it has become apparent that the magic bullet is the charitable trust. This, however, does not mean that charitable trusts are necessarily easy to utilize. It is just that of all the financial and related services an advisor can offer the wealthy, charitable trusts are the most intensely tied to the core of the interpersonal

relationship between the affluent individual and the advisor. It is this relationship which is the key determinant of success when working with the wealthy.⁴

However, in order to imbue charitable trusts with magic requires that the financial institution understand the dynamics of the charitable network and the way in which it can skillfully integrate itself into this network. It also necessitates being able to combine this orientation with

the market research previously referred to. Thus, the financial institution must employ an understanding of the buying behavior patterns of the affluent and use this sagacity to work the charity network.

When dealing with the charity network and charitable trusts in particular, the number of competitors dramatically multiplies. Attorneys and accountants are now also intimately involved. At the same time, personal philanthropic advisors are

very much competitors to the more traditional advisors to the affluent.⁵ Nevertheless, very few advisors to the affluent have made concerted attempts to adroitly "work" the charity network. Before focusing on the nature of the magic, it is necessary to understand the way in which advisors are approaching the matter of promoting — and most often not promoting — charitable trusts.

Limitations And Opportunities

It is widely recognized among all the advisors to the wealthy that charitable trusts are an extremely attractive service. Their irrevocable nature combined with their long, if not unlimited, life make them the ideal product from the advisor's perspective.

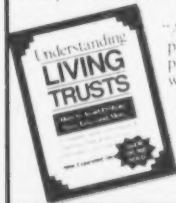
Regrettably, advisors to the wealthy who offer this service fail to recognize its true value. They tend to see charitable trusts as nothing more than just another product to sell. Actually, charitable trusts can be a key component of the relationship between the advisor and the client. When viewed in this fashion, appropriate relationship management methodologies can be utilized which result in the intense bonding of the client to the advisor. It also sets the stage for generating new business. These functions will be discussed in greater detail in the next section. Presently, it is worthwhile to see how the advisors fail to exploit this service and what they are losing by their lack of action.

In a survey of the senior managers of 47 private banks, 32 law firms, 31 accounting firms and 27 money managers who are all capable of providing the service, it was discovered that not one of these advisors were actively pursuing the field. Meanwhile, they nearly all expressed a desire to be more involved in promoting charitable trusts among their clientele. While they recognize that the establishment of charitable trusts has value to their organizations, they nevertheless have been incapable of taking advantage of the opportunity.

Except for the two private banks and five accounting firms who concluded that there was not a way to successfully promote charitable trusts among their clientele, all the other competitors explained that they are exceedingly interested in making the effort. Among all the se-

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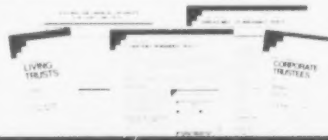


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nior managers, the big stumbling block is how to work the charity network. At a more basic level, the problem is how to motivate existing clients to establish charitable trusts. As one senior manager of an old-line private bank explained, "I just don't know what to do."

Before doing anything different, it is necessary to determine just what is being done. When trained observers were used to unobtrusively evaluate the selling of services offered by these organizations — including charitable trusts — it was painfully apparent that there was a lack of organizationally-driven sales expertise.

The Four Components

There are four components to the selling of such services to the affluent. They are: (1) the presentation/sales skills of the advisors, (2) the ability to utilize the environment, (3) the quality of the presentation materials employed, and (4) the effectiveness of the argument.⁶ Not only are these components critical to the marketing of charitable trusts, they are also essential to selling almost any type of sophisticated service to anyone.

For the most part, the presentation/sales skills could be dramatically improved. In particular, considerably more effort needed to be made with respect to improving rapport and then leveraging off this foundation. Concurrently, a more effective use of the environment is required. In nearly all cases, the environment was taken for granted. In effect, a significant opportunity is overlooked. Along the same lines, the presentation materials tended to be quite lacking in motivational properties. Actually, they served to dampen interest by being inappropriately data-dense. Finally, and most importantly, the argument tended to be glaringly absent.

With respect to charitable trusts, the argument must center on the psychology of the affluent individual. The argument is the rationale for purchasing a service. It is essential to understand the varying motivations of the wealthy with respect to donating, not only in order to market charitable trusts to existing clients, but also to tap into the charitable network. However, for the most part, research into philanthropy has centered on who is do-

minating to whom, the amounts involved, and how the arrangements are structured. Moreover, it is the motivational attributes which are the consequential considerations in the selling of charitable trusts.

Psychographic Segments

Based on a study of 471 affluent donors who established charitable trusts of \$1 million or more in 1989, four empirically-derived psychographic segments were identified.⁷

- Affiliators who are principally motivated to donate because of social ties as well as humanitarian reasons.

- Pragmatists who tend to focus on the tax benefits in conjunction with the social benefits of establishing charitable trusts.

- Dynasts who tend to be associated with "old money." Their motivation is a function of family tradition.

- Repayers who have directly or



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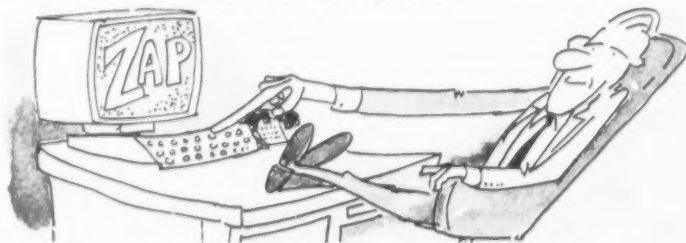
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indirectly benefited by the services of a charity.

This psychographic segmentation scheme can be employed by the advisors to the affluent as well as the charitable institutions to dramatically improve their marketing efforts. Such an orientation is necessary in order to be successful in the marketing of charitable trusts. By utilizing these psychographic segments, the advisor can construct arguments which have the greatest potential to motivate an affluent individual.

While it is clear that there are substantial obstacles to the marketing of charitable trusts by advisors, it is important to recognize the enormous opportunities that exist. These opportunities are not simply the considerable profits that can be made by doing so; these opportunities are the extreme likelihood that the market is quite receptive to the idea of acting in a socially as well as personally beneficial manner.

The Focus On 'Social Good'

The focus on "social good" is becoming more and more a part of the conscience of American society. One example of this is the highlighting by the Presidency on a "kinder and gentler nation." In association with this is the "points of light" perspective. Empirical evidence has repeatedly shown that monies donated to non-profits produce significantly greater results than equivalent funds channeled through similar government programs. That is, philanthropic actions result in a more ef-

fective use of financial resources than the efforts of the government. Thus, the affluent — and everyone else, for that matter — are more and more positively inclined to become involved or to increase their involvement in "good works."

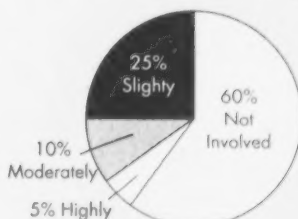
More specifically, among two private banks being studied, one issue was to evaluate the potential among their existing client base for charitable trusts. Of the 1,744 clients of these two banks, only 52 (3 percent) had established charitable trusts. In all these cases, the banks were not the motivating force in the creation of the trusts.

The question becomes, how many of the remaining 1,692 clients would be attracted to the service if it were well-presented? The senior managers of the private banks were then asked to identify the percentage (based on a scale divided into increments of 5 percent) of the clients which were not involved, were slightly involved, were moderately involved and were highly involved in philanthropic activities. It is important to note that not being involved does not mean that the wealthy clients would not contribute. It refers to the fact that they do not consider philanthropic activities to be a significant component of their lives.

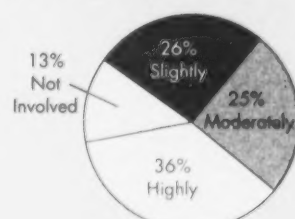
The results were collated, and they believed that 60 percent of the 1,692 clients were not involved with philanthropic activities. Only 25 percent were slightly involved. Ten percent were moderately involved. And, the remaining 5 percent were highly

EXHIBIT I

Perceived Percentages Of Activity In Charitable Giving: Bank Management Versus Clients



Percentage of client involvement with philanthropic activity where charitable trusts had not already been established as perceived by bank senior management.



Percentage of these clients' own perceptions of personal philanthropic activity.

involved. Even if their estimation was indeed accurate, this means that these private banks should be promoting charitable trusts to 85 clients — that percent which is highly involved. In fact, the banks should also be promoting the service to an additional 170 clients — those that are moderately involved. However, these actions were not being undertaken.

Those 1,692 were contacted by telephone and queried concerning their involvement in philanthropic activities. In addition to their self-report rating, the clients were asked if they were on committees of boards of non-profits. Every client was reached and responded to the questions.

The greatest number of clients, 612 (36 percent) said that they were highly involved. All of the highly involved clients were on the board of trustees of non-profits and/or on important committees.

Four hundred and twenty-seven (25 percent) of the sample identified themselves as being moderately involved. Only 269 (63 percent) of them were on the board of trustees of non-profits and/or on important committees. Four hundred and forty-one (26 percent) considered themselves to be slightly involved. Not one of them was on the board of trustees of a non-profit. However, 92 (21 percent) said they served on significant committees. The remaining 212 (13 percent) of the sample said that they were not at all involved in philanthropic activities.

A Golden Opportunity

Evidently, there is dramatically more opportunity to market charitable trusts to the client base of these private banks than senior management believes. It would not be surprising that a great many other advisors to the wealthy who can provide the charitable trust service have an untapped market in their very own client base. The two most promising groups are those that are highly and moderately involved. This is a total of 1,039 (61 percent) of the sample.

Indisputably, a momentous opening to deepen the private bank's relationship with its clients, as well as improve its bottom line, is being missed. Concurrently, related opportunities are thereby not being pursued.

Advisors need to look beyond the

charitable trusts as an individual product and recognize the value that exists in the charitable network. Within the United States, the affluent are cornerstones of the charity network. By deftly promoting charitable trusts, the advisor will be placed in greater and greater contact with the wealthy.

If, for instance, the accompanying objective is to acquire more discretionary investment management accounts from the well-to-do, then by working the charity network, the advisor is positioned to do so. It becomes a matter of the proficient use of strategic networking, which is the most effective means of garnering new clients.⁸

One of the greatest obstacles of strategic networking is that initial contact and the obtaining of referrals. These two problems become moot because the advisor is readily presented in a very positive light to the wealthy individuals by the other wealthy individuals who are highly involved with charitable causes.

Aside from the expanding of an affluent client base, by working the charity network, advisors are also placed into contact with the independent sector — the non-profits. Consider the potential to acquire foundation and endowment monies to manage. By assisting the affluent, it is possible to build the bridges that are essential for an investment advisory firm to be employed to manage these monies.

Along similar lines, depending on the services an individual advisor offers, he or she is positioned to benefit by obtaining business from the non-profit itself. For example, a family office, due to its marketing efforts at promoting philanthropy among the affluent, is now providing financial and legal advisory services to a number of non-profit organizations.

With this in mind, banks are well situated to work with non-profits. Aside from all the banking business they can garner, there are marketing strategies which can result in not only the establishment of charitable trusts but will simultaneously fulfill, in part, the bank's obligation to its community as dictated by the Community Reinvestment Act. Thus, in the worst case and terribly unlikely scenario where new charitable trusts are not established, the bank still comes out ahead because the government is, in part, satisfied



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as the bank is adhering to its legal obligations under the Community Reinvestment Act and extensive positive public relations are being generated.

In sum, the limitations are predicated on a lack of expertise. The advisors tend not to be particularly proficient with working the charity network and promoting charitable trusts. Current efforts focused on understanding and promoting philanthropy will enable them to overcome this obstacle. At the same time, the opportunities are tremendous. Undeniably, charitable trusts are inherently highly profitable and the market for the service has Promethean potential.

Why A Magic Bullet?

While the psychographic segmentation scheme is important in the marketing of the service because it is critical to the construction of the argument, it is also important to understand why a charitable trust is a magic bullet from the perspective of the advisor. An understanding of the nature of the magic not only provides greater insight into the psychology of affluent donors, it furthermore results in the identification of marketing strategies.

The intensity of the relationship that exists between an individual who has established a charitable trust and his or her advisors is quite powerful. Based on 27 in-depth interviews with wealthy individuals who established charitable trusts, the power of the charitable trust to positively transform the relationship was blatantly evident.

Before the creation of the charitable trust, the perceptions of the advisor were moderately satisfactory. This situation dramatically changed once the charitable trust was established. Subsequent to its creation, the perceptions of the advisors were significantly enhanced. It is necessary to note that it was not the advisor but the charity that prompted the creation of the charitable trust. Nevertheless, the advisors benefited considerably.

Without question, with regard to investment advisory firms, perceptions of satisfaction are more important than objective investment performance. The most successful investment advisory firms are the ones which actively manage the expectations of their clients. They are

able to capitalize on positive investment performance and simultaneously mitigate the effects of poor investment performance.⁹

Charitable trusts are a remarkably effective tool in the management of client expectations. Their existence, at the very least, activates the process of cognitive dissonance. The result is satisfaction — even when the investment advisory firm is merely managing the funds and had absolutely nothing to do with the selling of the service.

The investment advisory firms of these 27 affluent donors are reaping unexpected rewards. Unfortunately, when the relationship managers of these clients were interviewed, it was painfully apparent that they did not recognize the benefits of the situation or the opportunities it created. This lack of recognition is likely to minimize any potentially positive outcomes concerning the management of the clients' expectations.

While the charitable trust can potentially be a very potent means of deepening the advisor's relationship with a well-to-do individual, in and of itself the service has limited magic. It is the responsibility of the advisor to take actions which leverage this situation.

More powerful are the relationships that develop as a function of guiding the client to establish a charitable trust. Those organizations, whether they are professional advisory or charitable, realize enormous positive ties to the affluent individual because they have assisted this person in the process of establishing a charitable trust. It is therefore in their best interest to become actively involved in promoting charitable trusts. This is most efficaciously accomplished by offering a philanthropic advisory service.

Whereas the charitable institutions are focused on their own organizations, the advisors are not so encumbered. This also requires that the advisors take a different approach in their promotion of the service. Based on observations of four family offices which are quite successful in this regard, it became apparent that by offering a "philanthropic advisory service," they are able to assist their non-family clients in obtaining the personal, social and financial benefits of their largesse.¹⁰

The family firms were providing this service implicitly. For them, it

was merely the operation of what they do for the founding family applied to their new clients. What other advisors need to do, therefore, is offer such a service. It should not be a fee-based service. It is provided without charge. The objective is to deepen the relationship between the advisor and the client.

The goal is not to push for the establishment of a charitable trust. Instead, the intention is to better serve the client in fulfilling his or her philanthropic goals. This alone will enable the advisor to better manage the client's expectations. Of course, the establishment of a charitable trust becomes the logical extension of a philanthropic advisory service.

Generating Involvement

This advisory service generates involvement. While there are numerous ways of generating involvement, the philanthropic advisory service is one of the most effective and it has great broad appeal. For instance, the importance of generating involvement has been empirically shown to be very rewarding when dealing with beneficiaries.¹¹ This strategy is evidently restricted to a limited number of clients. Although the trust institution is well advised to generate involvement with respect to these clients, the approach is clearly not applicable to all trust clients.

On the other hand, a philanthropic advisory service is viable with almost all affluent clients. Admittedly, not all wealthy individuals possess a social conscience and are inclined to act accordingly. Still, a vast number of them are interested in examining social issues. Viewing the philanthropic advisory service as a relationship-enhancing process, the advisor is able to guide the client in a way the client finds acceptable. This, coupled with the tax benefits of charitable trusts — specifically, charitable remainder trusts — will tend to result in their eventual creation.

Even after a charitable trust has been established, the advisor needs to continue providing the philanthropic advisory service. The methodology of generating involvement should not stop or even peak once the charitable trust has been set up. Generating involvement is a continuous process. By continuing with the philanthropic advisory service, the advisor ensures that prob-

lems surrounding the charitable trust with regards to the charity of the advisor are quickly and properly handled.

It will also enable the advisor to continue to enhance his or her relationship with the affluent individual. This might even result in the creation of additional charitable trusts and/or greater monies being placed in the already established charita-

ble trust. Irrespective, it will permit the advisor to greatly improve his or her relationship with the affluent individual and thereby be positioned to take advantage of ripple effects.

From a strictly business point of view — the making of money — charitable trusts and the accompanying management of the relationships are an exceptional means of maintaining an affluent client base

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as well as significantly expanding it. It is a situation which is becoming even more attractive as the competitive environment becomes more intense.

Charitable trusts and the philanthropic advisory services that should be used in conjunction with them can permit an advisor to viably assist the affluent individual in meeting his/her philanthropic goals while effectively managing his/her expectations. The result is a highly satisfied client who is more than likely willing to overlook a less than stellar performance with respect to other provided services.

This is clearly seen with respect to investment management performance. Even when the investment advisor produces poor investment re-

sults, the client tends to still be very satisfied with the advisor. And it is the subjective issue of satisfaction as opposed to objective investment performance which will be the deciding factor in whether the client will continue to patronize the investment advisor.

Conclusion

Of course, objective investment performance impacts on the client's level of satisfaction. However, charitable trusts and the philanthropic advisory service will enable the investment advisor to maintain the client long enough to improve his/her portfolio returns. Few other ways of managing expectations this potent exist.

Not only by using this marketing

perspective is it probable that advisors can maintain their client base, but they can also expand it. Within the U.S., the charity network is the most attractive and severely underused means of generating new business. The use of marketing strategies centered on philanthropic goals which are focused on the eventual establishment of charitable trusts will empower advisors so they can transverse the many worlds of wealth as an honored guest. This translates into numerous opportunities to market their services to the well-to-do.

Of greater importance is that by taking this approach, the advisor will not only handsomely prosper, he/she is simultaneously working to create a more benevolent society. Unfortunately, the number of worthy causes continues to multiply. At the same time, available funding continues to decline. The promotion of charitable trusts by advisors assists these many worthy causes at a time when a great need exists. □

FOOTNOTES

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